

Office of Chief Counsel
Internal Revenue Service
Memorandum

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to: Associate Area Counsel - Salt Lake City
(Small Business/Self-Employed)

from: Stuart D. Murray
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(Procedure & Administration)

subject: Applicability of Interest Netting Under I.R.C. § 6621(d) to Interest on Underpayments and Overpayments of a Consolidated Group and Its Members

This Chief Counsel Advice, which has been coordinated with the Associate Chief Counsel (Corporate), Branch 2, responds to your request for assistance. This advice may not be used or cited as precedent.

ISSUES

1. Whether I.R.C. § 6621(d) allows interest on an overpayment of tax resulting from a consolidated corporate income tax return to be netted against interest on an underpayment of tax resulting from an income tax return filed by one of the subsidiary members of the group for an earlier taxable year when it was not a member of the group.
2. Whether I.R.C. § 6621(d) allows interest on an overpayment of income tax resulting from a consolidated group's return to be netted against interest on an underpayment of employment or excise tax by a member of the group for a taxable period after consolidation.

CONCLUSIONS

1. Section 6621(d) does not allow for the netting of interest between an overpayment of a consolidated group's income tax for one taxable year and an underpayment of a member's income tax for a prior taxable year because the consolidated group and the member are not "the same taxpayer" for purposes of both the overpayment and the underpayment.
2. Section 6621(d) does not allow for the netting of interest between an overpayment of a consolidated group's income tax and an underpayment of a member's employment or excise tax because the consolidated group and the member are not "the same taxpayer" for purposes of both the overpayment and the underpayment.

FACTS

This advice has been requested to assist in the proper processing of several ongoing complex interest cases, each of which presents either the first or second issue above. As we understand it, all of the cases involve consolidated groups of corporate taxpayers. Depending on whether the case concerns Issue 1 or 2, the cases fall into one of two situations described in your request.

The basic fact pattern involves a corporate taxpayer, A Inc., that for Tax Year 1 was not a member of a consolidated group of taxpayers and filed its own Form 1120, *U.S. Corporation Income Tax Return*. A Inc. underpaid its income tax, either as reported on the return or as determined after examination. In TY 2, A Inc. joined a consolidated group of corporations with a common parent, B Inc., which is the agent for the group. For TY 2, the consolidated group, B Inc. & Subsidiaries, filed a consolidated Form 1120 reporting an overpayment of income tax. Also for TY 2, A Inc. filed its own employment and excise tax returns, as did B Inc. (and the other members of the group). A Inc. underpaid its employment or excise tax for TY 2.¹

Interest under section 6601 has accrued on A Inc.'s underpayment of its TY 1 income tax at the rate established in section 6621(a)(2), and interest has accrued and is allowable on B Inc. & Subsidiaries' overpayment of income tax in TY 2, at the section 6621(a)(1) rate. Likewise, underpayment interest has accrued on A Inc.'s underpayment

¹ As to Issue 2 and our conclusion, it does not matter if the underpayment in TY 2 was of employment or excise tax or if both were underpaid. We treat them the same for purposes of our advice. They are distinguishable from income taxes for TY 2 because a consolidated group may not file consolidated employment or excise tax returns, so any unpaid or underpaid employment or excise tax of a member of the group is computed solely with regard to that member. And that member is the only taxpayer liable for the tax (the other members are not severally liable like they are for their consolidated income tax, *infra*). In addition, the regulations establishing an agent for the group and reserving matters to the agent (section 1.1502-77) do not apply to employment or excise taxes, with each member acting for itself. That said, at bottom, Issues 1 and 2 both concern a liability of A Inc. (whatever the type of tax) that is separate from the group's overpayment of income tax in TY 2. The necessary analysis is identical, and our conclusion for one is fundamentally the same as for the other.

of employment or excise tax for TY 2. The periods for which underpayment interest and overpayment interest are payable overlap at least to some extent.

In the first of the two situations in your request, B Inc., as common parent and agent for the group, requests that the Service net the interest payable to the group on its TY 2 income tax overpayment against the interest A Inc. owes on the underpayment of its TY 1 income tax. In the second situation, B Inc. requests that the Service net the interest payable on the group's TY 2 income tax overpayment against A Inc.'s TY 2 employment or excise tax underpayment.

LAW AND ANALYSIS

Section 6601 imposes interest on any nonpayment or underpayment of a Title 26 tax running from the due date of payment to the date paid. Section 6611 authorizes the payment of interest on an overpayment of an internal revenue tax. If the overpayment is allowed and paid as a credit, interest runs from the overpayment date to the due date of the amount against which the credit is applied. I.R.C. § 6611(b)(1). If the overpayment is allowed and paid as a refund, interest runs from the overpayment date to a date determined by the Service that is no more than 30 days before the date of the refund check. I.R.C. § 6611(b)(2).

Section 6621(a)(1) establishes the interest rate for overpayments, and section 6621(a)(2) establishes the interest rate for underpayments. Section 6621(d) provides that to the extent interest is payable for any period under section 6601 and allowable under section 6611 on equivalent underpayments and overpayments by "the same taxpayer," the net rate of interest under I.R.C. § 6621 on the underpayment and overpayment amounts shall be zero for the overlapping period. To qualify for interest netting, therefore, the same taxpayer must have both incurred the underpayment and made the overpayment.

"Taxpayer" is defined in section 7701(a)(14) as "any person subject to any internal revenue tax." "Person" means and includes a corporation. I.R.C. § 7701(a)(1). We construe section 6621(d)'s use of "the same taxpayer" to mean the taxpayer, whether individual or entity, liable for both the tax that was underpaid and the tax that was overpaid. If different, section 6621(d) does not apply.

In the two situations addressed in this advice, A Inc. is the taxpayer liable for the underpayment of income tax in TY 1 and the underpayment of employment or excise tax in TY 2. The taxpayer liable for the income tax overpaid in TY 2 is the consolidated group, B Inc. & Subs. Thus, the taxpayer associated with the underpayment (regardless of the type of tax) is not the same as the taxpayer associated with the overpayment. Under the facts, the consolidated group as a whole and each member other than A Inc. is not liable for A Inc.'s TY 1 income tax or TY 2 employment or excise tax.

A Inc.'s liability for the TY 2 income tax as a member of the consolidated group does not change our conclusion—it does not make A Inc. the taxpayer entitled to interest payable on the overpayment. A Inc.'s liability for the tax reported on the group's consolidated return derives from the treatment of consolidated returns in the applicable regulations (Treas. Reg. § 1.1502-1, *et seq.*), but we find nothing in that treatment that requires or suggests that when corporate taxpayers consolidate, the result is that the group and each consolidating member become one and the same taxpayer. Consolidated return filing has certain defined effects, but they are not sweeping.

Section 1501 gives to an affiliated group of corporations the privilege of filing a consolidated income tax return. By filing the return, all of the members of the group consent to be bound by the consolidated return regulations prescribed under section 1502. The regulations state that the tax liability of a group for a consolidated return year includes the tax on the group's consolidated taxable income for the year, which in turn includes each member's separate taxable income. Treas. Reg. §§ 1.1502-2(a), 1.1502-11(1). The regulations further provide that the group's common parent and each subsidiary that was a member during any part of the consolidated return year are "severally liable" for the tax computed under the regulations. Treas. Reg. § 1.1502-6(a); *Turnbull, Inc. v. Commissioner*, 373 F.2d 91 (5th Cir. 1967).

It is clear from these provisions that a consolidated return (assuming it is valid) satisfies each member's requirement to file an income tax return for the year—the consolidated return is effectively each member's return—and each member is liable for all of the tax required to be shown on the return. But a consolidated return is not the return of any one member alone, and the tax liability for the year is not confined to any one member's taxable income. A consolidated return is the product of affiliated corporations that are separate taxable entities coming together to mutually meet their income tax return filing obligations. In doing so, they file as one entity (B Inc. & Subs.). *International Tel. & Tel. Corp. v. United States*, 608 F.2d 462, 469 (Ct. Cl. 1979) ("The consolidated return regulations are and always have been a means for the practical enforcement of a legal fiction, namely, that certain groups of corporations are, for purposes of United States income tax, one taxpayer."); *American Standard, Inc. v. United States*, 602 F.2d 256, 261 (Ct. Cl. 1979) ("The basic purpose behind allowing corporations to file consolidated returns is to permit affiliated corporations, which may be separately incorporated for various business reasons, to be treated as a single entity for income tax purposes as if they were, in fact, one corporation.").

As the return is that of the group, the overpayment, and interest on the overpayment, is also the group's, not that of any single member or subgroup of members. See I.R.C. § 6402(a) (providing for any offset against the liability of, and any credit or refund in favor of, "the person who made the overpayment"); *United States v. Williams*, 514 U.S. 527 (1995) (holding that the person who paid the tax was the "taxpayer" for purposes of filing a refund claim); *Western Pac. R.R. Corp. v. Western Pac. R. Co.*, 197 F.2d 994, 1003 (9th Cir. 1951) ("[T]he benefit of consolidated returns is for all corporations in the

group.”), *vacated on other grounds*, 345 U.S. 247 (1953).² As to a refund of a consolidated group’s overpayment, under the regulations, only the common parent, as sole agent for the group (unless a substitute agent is designated), may file a claim for a refund of an overpayment. Treas. Reg. § 1.1502-77(a)(2)(v). If the Service grants the claim, the refund “is made directly to and in the name of the common parent and discharges any liability of the Government to any member with respect to such refund.” *Id.* A parent can then distribute the refund in accord with any agreement between the affiliated corporations.

Given that a consolidated return is a combined return for multiple corporations, all of which are liable for the associated tax, and any overpayment is not deemed an overpayment of any single member, there does not appear to be a basis to treat a member with a separate underpayment as the same taxpayer responsible for a consolidated overpayment. Even allowing that each member is the “taxpayer” for purposes of their consolidated return, we are not prepared to say that each member is the same taxpayer as any other member of the group for any purpose beyond the consolidated return, such as interest netting under section 6621(d). We are aware of no authority to make that leap. See *Helvering v. Morgan’s, Inc.*, 293 U.S. 121, 127 (holding that after affiliation, corporations continue to be “separate taxable units,” the same as before affiliation, despite filing consolidated returns, the only effect of which is “to unite them for the purpose of [the consolidated] tax computation and the equitable apportionment between them of the tax”).

We find support for our determination by analogy to offsets under section 6402. The Service has authority to offset a taxpayer’s overpayment against any liability of the taxpayer for a different taxable period or type of tax before refunding any balance to the taxpayer. I.R.C. § 6402(a). When there is interest payable on both a taxpayer’s underpayment and an offsetting overpayment, section 6601(f) eliminates the underpayment interest for the overlapping period during which interest would have been allowable to the taxpayer on the overpayment had the underpayment and overpayment

² We make that statement notwithstanding the case of *In re Bob Richards Chrysler-Plymouth Corp.*, 473 F.2d 262 (9th Cir. 1973), referenced in your request. The court in *Bob Richards* held that a parent corporation could not keep a tax refund resulting from a consolidated return that was filed with a wholly-owned subsidiary in bankruptcy. Nor could the parent set off the refund against unsecured debt owing from the subsidiary. The refund at issue was generated entirely from the bankrupt subsidiary’s NOL, which the subsidiary could have carried back for a refund for a prior separate year. According to the court, the refund was a “valuable asset” of the subsidiary, and to have allowed the parent to keep it, rather than turn it over to the bankruptcy trustee, would have been unjust enrichment. 473 F.2d at 264, 265. Whatever authority the case may offer for the rights of a group member to an equitable allocation of a consolidated refund (at least when there is no agreement between the members), the opinion is inapposite here for two reasons. First, the case was not a section 6621(d) interest netting case. Second, what the court was concerned with was the allocation between group members after a refund is paid. The court did not hold that for purposes of tax administration a subsidiary should be treated as the taxpayer that made an overpayment for a consolidated return year simply because the overpayment was attributable to the subsidiary.

not been offset.³ Section 6601(f) by its terms does not apply to the extent section 6621(d) applies. While section 6601(f) zeroes out overlapping underpayment and overpayment interest in cases of setoff, the evident purpose of section 6621(d) was to extend the same relief in cases without a setoff. H.R. Conf. Rep. No. 105-599, at 256-57, 1998-3 C.B. 1010-1011 (1998). It is reasonable then to interpret section 6621(d) as applicable to instances in which unilateral setoff would have been permissible. Conversely, it is also reasonable to assume that section 6621(d) is inapplicable in cases in which setoff would have been unavailable.

In the scenario of an underpayment by A Inc. and a subsequent overpayment by B Inc. and its subsidiaries (including A), the Service could not of its own accord offset the overpayment against the underpayment.⁴ See *Hart Glass Mfg. Co. v. United States*, 118 F.2d 828, 829 (7th Cir. 1941) (holding that the Service improperly applied a company's tax overpayment to a liability of an affiliated company). B Inc., as the agent of the group, could conceivably consent to the offset, see Treas. Reg. § 1.1502-77(a)(2)(ii), (iv), which amounts to the group voluntarily paying A Inc.'s separate tax. Any taxpayer, however, can pay another taxpayer's tax. IRM 20.2.4.6.5(1) (03-01-2002) ("An overpayment and the interest thereon may be credited to the liability of a different taxpayer with the overpaid taxpayer's consent."). For example, an individual taxpayer can request that instead of a refund the Service credit his or her overpayment to another individual's unpaid tax, but assuming the Service makes the credit, that does not mean section 6601(f) applies. Nor does it render the individuals the "same taxpayer" within the meaning of section 6621(d). The same approach should apply if the request comes from a consolidated group (through its agent) and the taxpayer to be benefited is a member with an underpayment for a pre-consolidation year.

For all of the above reasons, we believe section 6621(d) interest netting is not allowable under the facts in this advice.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

The law in the area of section 6621(d) and consolidated returns is so far largely (if not entirely) uncharted. This office has not previously given definitive advice or guidance on the issues in this memorandum. Moreover, to our knowledge, no court has addressed them. If based on this advice, the Service denies interest netting in the cases for which the advice is issued, and one or more of the taxpayers challenges the denial in litigation,

³ Section 6601(f) does not explicitly require that the taxpayer responsible for the underpayment and the overpayment be the same, but it is implied since Section 6402(a) speaks of the "liability of the person who made the overpayment."

⁴ In the reverse situation—i.e., an overpayment by A Inc. for TY 1 and an underpayment by B Inc & Subs. (including A Inc.) for TY 2—the Service may, without consent, offset A Inc.'s overpayment against the group's underpayment because A Inc. (as already explained) is severally liable for the underpayment for the year in which A joined in filing a consolidated return. The Service is authorized to collect the underpayment from any member, including A, through setoff or otherwise.

there is, of course, a hazard that the government's position will not prevail. We do not, however, consider the hazards of litigation to be any greater than normal. We believe the position articulated herein is sound and fully defensible.

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Please call (202) 622-4910 if you have any further questions.